

Message Text

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ACTION EA-09

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TREASURY DEPT WASHDC

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E.O. 11652: N/A

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SUBJECT: PROMOTION OF YEN SHIFT - YEN IMPORT FINANCING

REFS: (A) TOKYO 12833, PARA 7; (B) TOKYO 13483, PARA 9

1. SUMMARY: GOJ IS ADOPTING MEASURES TO PROMOTE YEN USANCE CREDITS ESPECIALLY FOR IMPORTS SO AS NOT TO RELY SO HEAVILY ON TRADITIONAL DOLLAR FINANCING OF JAPAN'S TRADE. OFFICIALS ADMIT THAT HIGHER DOMESTIC INTEREST RATES COMPARED WITH THOSE FOR SHORT-TERM DOLLAR CREDITS WILL GREATLY HINDER THIS YEN SHIFT. THEREFORE, THEY CONSIDER THE PROCESS AS EVOLUTIONARY AND DO NOT REPEAT NOT ANTICIPATE RAPID OR SIZEABLE SHIFT IN TRADE FINANCING IN THE FORESEEABLE FUTURE. THIS IS CONFIRMED BY KNOWLEDGEABLE JAPANESE BANKERS WHO SAY BANKS MUST "RESPECT" REQUESTS OF THE GOJ AND THEY "WILL COOPERATE" ALBEIT RELUCTANTLY WITH ADMINISTRATIVE GUIDANCE BEING USED TO IMPLEMENT GOJ POLICY. FOLLOWING REPORT ON GOJ MEASURES IS BASED ON FINATT DISCUSSIONS WITH OFFICIALS AT MOF, BOJ AND MITI AND BANKERS AND IS CONSIDERABLY MORE ACCURATE AND EXTENSIVE THAN RECENT PRESS REPORTS ON SUBJECT, E.G., JAPAN ECONOMIC JOURNAL SEP 14.

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2. GOJ FINANCIAL OFFICIALS HAVE BECOME CONCERNED THAT YEN EXCHANGE RATE IS BEING "DISTORTED" IN TRADING OUTSIDE OF JAPAN BECAUSE YEN DEMAND IN LONDON AND NEW YORK MARKETS IS GREATER THAN YEN SUPPLY. THIS ATTRIBUTED TO FACT THAT 20 PERCENT OF JAPAN'S EXPORTS ARE DENOMINATED IN YEN WHEREAS ONLY 1 TO 2 PERCENT OF IMPORTS ARE YEN-DENOMINATED (SEE REF A), IF YEN SHIFT ON IMPORT FINANCING IS SUCCESSFUL, IT WILL LESSEN DOLLAR DEMAND AND INCREASE YEN SUPPLY AND THEREBY HAVE SOME EXCHANGE RATE IMPACT. ON OTHER HAND, FINATT BELIEVES MERELY SHIFTING TRADE INVOICING FROM DOLLARS TO YEN NEED NOT HAVE ANY EXCHANGE MARKET IMPACT.

3. SECOND REASON MENTIONED FOR PROMOTION OF YEN IS TO REDUCE OR PERHAPS PREVENT HEAVY RELIANCE ON SHORT-TERM FOREIGN DOLLAR BORROWING. THAT RELIANCE CONSIDERED RISKY IN VIEW OF EURODOLLAR MARKET PROBLEMS FOLLOWING HERSTATT BANK FAILURE AND FACT THAT JAPAN'S GROSS SHORT-TERM BANKING LIABILITIES TO FOREIGNERS HAVE REACHED ROUGHLY DOLS30 BIL LEVEL.

4. THIRD REASON ADVANCED IS THAT IT WOULD REDUCE FOREX RISK FOR JAPANESE TRADERS BY DENOMINATING TRADE IN YEN (AT PRESENT ONLY IMPORTS OF SHRIMP ARE DENOMINATED IN YEN). HOWEVER, IT SIMULTANEOUSLY RAISES THE FOREX RISK FOR FOREIGNERS. MOREOVER, THERE IS NO DIRECT LINK BETWEEN INVOICING IN YEN AND FINANCING SHORT-TERM TRADE CREDITS IN YEN. AS WAS POINTED OUT IN REF B, 20 PERCENT OF JAPAN'S TOTAL EXPORTS ARE INVOICED IN YEN AND THESE ARE ENTIRELY FINANCED IN DOLLARS OUTSIDE OF JAPAN.

5. FOURTH OBJECTIVE, ACCORDING TO MITI IS TO PROMOTE IMPORT DEMAND BUT FEW FINATT CONTACTS WERE OPTIMISTIC THAT MEASURES WOULD HAVE A SIGNIFICANT IMPACT ON FUTURE LEVEL OF IMPORTS.

6. FOLLOWING MEASURES ARE BEING ADOPTED:

A. ISSUANCE OF "COVER BILLS" IN LARGE DENOMINATIONS TO COMBINE NUMEROUS SMALLER ACCEPTANCE BILLS IN ODD AMOUNTS IMPROVES THE MARKETABILITY OF THESE INSTRUMENTS IN THE BILL DISCOUNT MARKET. COVER BILLS FOR YEN IMPORT CREDITS ARE NOW BEING PROMOTED AFTER SOME INITIAL SUCCESS IN ISSUING LIMITED OFFICIAL USE

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COVER BILLS FOR EXPORT USANCE CREDITS.

B. QUARTERLY CREDIT CEILINGS IMPOSED UNDER BOJ WINDOW GUIDANCE WILL BE INCREASED ON A CASE-BY-CASE BASIS IF BANK CAN SHOW IT HAS SHIFTED FROM DOLLAR TO YEN USANCE FINANCING. AT PRESENT DOLLAR TRADE FINANCING IS NOT INCLUDED IN THESE CEILINGS WHICH APPLY TO YEN DISCOUNTED BILLS AND LOANS. APPARENTLY BOJ HAS CONCEDED THIS MEASURE TO MOF (SEE REF A) WHICH WILL BE APPLIED SYMMETRICALLY TO SHIFTS IN EXPORT AND

IMPORT FINANCING.

C. YEN IMPORT FINANCING CAN BE HANDLED EITHER OF TWO WAYS BUT CREDIT CEILINGS APPLY TO BOTH: (1) IMPORTER SELLS PROMISSORY NOTE TO BANK BUT SUCH BANK CREDIT IS NOT ELIGIBLE FOR BOJ RE-DISCOUNT OR SALE TO THE BILL DISCOUNT MARKET; (2) JAPANESE IMPORTER OPENS YEN LETTER OF CREDIT AND FOREIGN EXPORTER DRAWS USANCE BILL AGAINST IT, WHICH IS THEN "ACCEPTED" BY JAPANESE OR FOREIGN BANK IN JAPAN. THESE USANCE BILLS ARE ELIGIBLE FOR BOJ DISCOUNT AND CAN BE SOLD TO THE BILL DISCOUNT MARKET. SALE OF SUCH BILLS DOES NOT REDUCE THE BANK'S ASSETS OF "BILLS ACCEPTED" BECAUSE SALE IS TREATED AS A LIABILITY (BILLS SOLD). AT MATURITY BANK BUYS BILLS BACK FROM MARKET OR BOJ AT PAR, THEREBY EXTINGUISHING BOTH ASSET AND LIABILITY ENTRIES.

D. MOF EFFORT TO IMPOSE MAXIMUM 20 PERCENT LOAN DEPOSIT RATION ON JAPANESE BANKS IS BEING EASED AND MAY HAVE TO BE ABANDONED (REF TOKYO A-756 12/30/74).

E. LONGER CREDIT TERMS THAN NORMAL 4-MONTH USANCE WILL BE ALLOWED FOR YEN IMPORT FINANCING. MITI HAS NOT YET FINALIZED DETAILS BUT PROBABLY IMPORTS OF AUTOS, COTTON, WOOL, WOOD, FISH PRODUCTS AND SUGAR WILL BE ELIGIBLE FOR YEN USANCE BY FINANCING PERHAPS UP TO ONE YEAR. THIS COULD PROVIDE AN INCENTIVE TO SWITCH FINANCING FROM DOLLARS TO YEN. AT PRESENT PRODUCTS ELIGIBLE FOR NON-STANDARD TERMS OF SETTLEMENT (I.E. MORE THAN 4-MONTHS CREDIT AFTER CUSTOMS CLEARANCE) ARE (1) COPPER ORE (MADE ELIGIBLE AFTER JAPANESE COPPER REFINERS VOLUNTARILY ADOPTED EXPORT RESTRAINTS SO AS TO REFRAIN FROM DEPRESSING WORLD COPPER PRICES) AND (2) RAW COTTON. DURING RECENT WORLD RECESSION JAPAN EXIMBANK GRANTED SPECIAL ONE-YEAR USANCE CREDITS TO LDC'S BUT THESE HAVE USUALLY BEEN LIMITED TO IMPORTS OF RAW MATERIALS SUCH AS OIL FROM NEW DEVELOPMENT PROJECTS.

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7. OBSTACLES TO YEN SHIFT: APPARENTLY VOLUME OF YEN EXPORT ACCEPTANCES REMAINS VERY SMALL DESPITE OFFICIAL ENCOURAGEMENT FOR THE PAST YEAR.

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ACTION EA-09

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A. TRADITION: FOR PAST 30 YEARS TRADING COMPANIES HAVE HAD EXCELLENT EXPERIENCE WITH DOLLAR TRADE FINANCING (ORIGINALLY ENCOURAGED BY GOJ) DESPITE GYRATIONS IN INTL MONEY MARKETS. BUSINESS HESITATES TO SHIFT TO YEN IN PART BECAUSE IT COULD THEN BE SUBJECT TO EVEN TIGHTER CREDIT CONTROL BY BOJ. RELATIONS WITH FOREIGN BANKERS MIGHT ALSO SUFFER, GIVING BUSINESSMEN AND BANKERS FEWER FINANCING ALTERNATIVES THAN PRESENTLY AVAILABLE. IT IS ALSO SAID THAT FOREIGN EXPORTERS DON'T WISH TO ALTER CURRENT TRADING TERMS.

B. INTEREST COSTS: BUSINESS AND OFFICIALS ALIKE SAY INTEREST COSTS IN JAPAN ARE HIGHER THAN DOLLAR FINANCING (CONTRARY TO WHAT WAS REPORTED IN REF B). THAT SITUATION IS EXPECTED TO CONTINUE. ESTIMATES OF THE AVERAGE INTEREST DIFFERENTIAL ARE APPARENTLY DIFFICULT TO MAKE BECAUSE CUSTOMER-BANK RELATIONS DIFFER WIDELY AND DETERMINE HOW MUCH ABOVE PRIME RATE BORROWER WILL HAVE TO PAY. BEST FINATT ESTIMATE IS THAT YEN TRADE FINANCING IS BETWEEN 0.5 AND 1 PERCENT HIGHER THAN DOLLAR FINANCING. BANKERS CITE MAIN OBSTACLE TO MAKING YEN FINANCING INTERNATIONAL ALLY COMPETITIVE IS THAT BOJ PLACES EVERY KIND OF CONTROL OF INTEREST RATES INCLUDING SHORT-TERM CALL AND BILL RATES, AS WELL AS OVER THE VOLUME OF CREDIT. FINATT BELIEVES PROFIT TO BANKS OF DOLLAR

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FINANCING IS PROBABLY HIGHER THAN YEN FINANCING. BORROWING ABROAD IS DONE PARTLY IN U.S. ACCEPTANCE MARKET (ONE-HALF, SAYS BANK OF TOKYO) AND PARTLY BORROWING EUROS DOLLARS. AT TIMES, AS AT PRESENT, U.S. BANKERS ARE EAGER TO INCREASE THEIR HOLDINGS OF ACCEPTANCES AND WILL CUT RATE BELOW 1.5 PERCENT MAXIMUM MARGIN.

8. FINATT COMMENT: JAPANESE CONTACTS ALL BELIEVE IMPACT OF ABOVE MEASURES WILL BE VERY SMALL AND SHIFT TO YEN IMPORT FINANCING WILL BE LONG EVOLUTIONARY PROCESS. PUBLIC STATISTICS WILL NOT BE READILY AVAILABLE TO MEASURE SUCCESS OF POLICY, EXCEPT PERHAPS IN THE BALANCE OF PAYMENTS FIGURES ON SHORT-TERM CAPITAL FLOWS. JAPAN'S TOTAL TRADE CURRENTLY RUNNING AT DOLS 100 BIL ANNUAL LEVEL. WITH NORMAL PRACTICE OF FOUR MONTHS TRADE CREDITS, TOTAL OUTSTANDING VOLUME OF TRADE FINANCING IS PERHAPS DOLS 35 BIL. EVEN SMALL SHIFT IN PERCENTAGE OF YEN FINANCING WOULD BE SIZEABLE DOLLAR AMOUNT. WHETHER THAT AMOUNT WOULD HAVE AN IMPACT ON THE FOREIGN EXCHANGE RATE, IN VIEW OF THE VERY SUBSTANTIAL FLOWS OF LONG-TERM CAPITAL, IS DIFFICULT TO ASSESS. MEASURES ARE TO BE IMPLEMENTED IN FACE OF NEGATIVE PROFIT INCENTIVE THROUGH ADMINISTRATIVE GUIDANCE. THERE IS CONSIDERABLE BANK AND TRADING COMPANY RESISTANCE TO YEN SHIFT AND DIFFERENCES OF OPINION WITHIN GOJ OF ALTERING PRESENT PRACTICES OF CONTROLLING DOMESTIC AND INTL CREDIT. EVEN GOVT MONOPOLY CORP AND AGRIC FOOD AGENCY ARE RESISTING CHANGES IN PRESENT TERMS OF IMPORTING TOBACCO, WHEAT, BARLEY AND RICE WITH DOLLAR USANCE CREDITS, MOF OFFICIAL ADMITS. THUS IT APPEARS TO FINATT THAT PROGRESS OF YEN SHIFT IN TRADE FINANCING COULD WELL BE A SLOW PROCESS. HODGSON

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